

MISREPRESENTATION IN CONSUMER INSURANCE:  
THE UNITED KINGDOM LEGISLATURE OPTS FOR A  
'REASONABLE CONSUMER' STANDARD

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## INTRODUCTION

The development of a parallel branch of contract law dealing specifically with consumers has achieved further impetus in the United Kingdom with the passing of the Consumer Insurance (Disclosure and Representations) Act, 2012 ('the UK Consumer Insurance Act'). This important legislative development brings a change to the accepted standard of care in non-disclosure/misrepresentation cases involving insurance claims. The former standard of the 'reasonable insurer', used for determining the materiality of a misrepresentation, has been lowered in this context to that of a 'reasonable consumer'. In South Africa, the law of insurance has not yet been brought into line with the Consumer Protection Act 68 of 2008 ('the CPA'). The question therefore needs to be asked whether the recent development in the UK jurisdiction is not a desirable change for our legislature to consider.

## SETTING THE SCENE

Contracts of insurance are viewed in English law and South African law as imposing a duty of the utmost good faith on both the insured and the insurer (see for example, s 17 of the (English) Marine Insurance Act, 1906; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501 (HL); *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd* [2003] 1 AC 469 (HL); *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* 1985 (1) SA 419 (A) at 431H–433F [Note: Joubert JA opted here to jettison the 'utmost' part of the phrase 'utmost good faith' as alien to Roman Dutch law]; D M Davis *Gordon & Getz: The South African Law of Insurance* 4 ed (1993) ch 6; M F B Reinecke, S W J Van der Merwe, J Van Niekerk & P H Havenga *General Principles of Insurance Law* (2002) paras 172–8). The South African law of insurance has developed under the influence of English law over the years. (Evidence of this can be found in the fact that both the Cape and the Orange Free State colonies adopted English insurance law by statute in 1879 and 1902 respectively. These provisions lasted until the repeal of these respective statutes in 1977. See also the judgment of Joubert JA in *Oudtshoorn Municipality* (supra).) Thus, despite the assertion of the majority in *Oudtshoorn Municipality* (supra) that Roman Dutch law was the authoritative source of the South African law of insurance, the influence of English law principles on our insurance law cannot be denied.

The English law of insurance, at least since the case of *Carter v Boehm* ((1766) 3 Burr 1905; 97 ER 1162) in the eighteenth century (if not before —

see Stephen Watterson 'Carter v Boehm' in Charles Mitchell & Paul Mitchell (eds) *Landmark Cases in the Law of Contract* (2008) 59), has recognised that a duty of disclosure is placed on the insured to reveal the facts within his knowledge which are relevant to the insurer's decision whether to grant the insured insurance cover (*Carter v Boehm* (supra) at 1909; s 18 of the (English) Marine Insurance Act, 1906). As to the question of what exactly can be viewed as 'relevant' in the above sense — or 'material' to use the modern term — a student of insurance law can see that even in the seminal case of *Carter*, Lord Mansfield was at pains to contain the duty of disclosure within reasonable bounds. Thus, for example, an insured need not disclose information which is within the knowledge of the insurer (*Carter v Boehm* (supra) at 1910). However, Hasson has shown that after *Carter's* case, which was decided in favour of the insured, the pendulum of English law swung firmly in favour of the insurer in this context (R A Hasson 'The doctrine of uberrima fides in insurance law — A critical evaluation' (1969) 32 *MLR* 615). In the (English) Marine Insurance Act, 1906, a duty of the utmost good faith is imposed upon both parties and this is said to give rise to a duty to disclose material facts to the insurer (see ss 17 and 18). As to what is material, s 18(2) of this Act outlines the test to apply as one that asks what would influence the judgment of the prudent insurer in fixing the insurance premium or determining whether the insurer would take the risk of granting cover.

The duty of disclosure therefore requires the insured to inform the insurer, when applying for insurance cover, of any fact which the insurer would deem material to its decision to grant such cover. Should the insured be too inexperienced in such matters to know whether a particular fact is important to insurers or not, he would stand to have his claim avoided — based on his failure to disclose — should he suffer a loss purportedly covered by the insurance contract. Should the insured dispute this avoidance of liability by the insurer, the insurer need only have one of its actuaries testify that such information was statistically relevant to the determination of its risk. Perhaps, one might argue in the commercial context that this is defensible, since a business enterprise should have its own legal counsel at its disposal and a paternalistic attitude by the legislature or the judiciary would not be appropriate here. However, the consumer context is different. Significantly, English contract law has seen a hiving-off of the law of consumer contracting since the late 1970s with the promulgation of the Unfair Contract Terms Act, 1977. This legislative development has now reached the English law of disclosure in the consumer insurance context with the promulgation of the UK Consumer Insurance Act.

The UK Consumer Insurance Act brings marked changes to the law on misrepresentation and disclosure in the context of consumer insurance. The most obvious changes are a reduction of the duty of disclosure to a duty simply not to make misrepresentations, with the standard of care required of the consumer in this process being that of the 'reasonable consumer' (see discussion below). This is a drastic change to English insurance law, where

the duty of disclosure had previously stood more or less unmoved from the position under the (English) Marine Insurance Act, 1906 as set out above (John Lowry, Philip Rawlings & Robert Merkin *Insurance Law — Doctrines & Principles* 3 ed (2011) 83–4). While South African law is less harsh than the former English law position with regard to non-disclosure in the insurance context (our standard of materiality is determined in terms of a ‘reasonable person’ test — see s 53(1)(b) of the Short-Term Insurance Act 53 of 1998 and s 59(1)(b) of the Long-Term Insurance Act 52 of 1998) the bar is still set higher than that of the ‘reasonable consumer’. With the coming into force of the CPA in April 2011, one needs to ask whether our law on disclosure and misrepresentation in the consumer insurance context does not also need revisiting.

This note will proceed to examine the South African law of disclosure and misrepresentation in the insurance context. This will then be juxtaposed with an excursus into and analysis of the UK Consumer Insurance Act. Thereafter the focus will shift to the issue of constructive notice to illustrate how an area of insurance law, that in the past has been marked by a lack of clarity, can be addressed. In practice, many consumer insurance contracts are effected through canvassing agents. Yet the uncertainty regarding the authority of the agent and his role within the broader context of the duty to disclose has led to unsatisfactory outcomes for consumers and insurers alike. In this respect, we argue that the manner in which the UK legislature has chosen to deal with this aspect of consumer insurance law shows, on a practical level, the potential that effective legislation might have to achieve a certain and equitable outcome for both consumers and the insurance industry.

## NON-DISCLOSURE AND MISREPRESENTATION IN SOUTH AFRICAN LAW

A misrepresentation is a false pre-contractual statement of fact (S W J Van der Merwe, L F Van Huyssteen, M F B Reinecke & G F Lubbe *Contract General Principles* 4 ed (2012) 89). To be actionable, a misrepresentation must mislead the misrepresentee (ie induce a misapprehension in the mind of the innocent party) but unless the misapprehension is material the contract will not be void on this ground (ibid). If a misrepresentation induces a misapprehension in motive only, the contract may be voidable if the innocent party would not have contracted but for the misrepresentation (ibid at 89–98 and 115–18). A claim for damages for the misrepresentation may also be brought if it was made fraudulently or negligently, since the making of a misrepresentation may be a delict (ibid at 98–9; Reinecke et al op cit para 179).

An omission to speak when under a legal duty to do so constitutes a misrepresentation by silence. A misrepresentation by silence is also referred to as a non-disclosure. Most of the relevant cases in the South African law of non-disclosure involve sales, with a redhibitory-type of relief being given where there was involuntary reliance by the purchaser on the seller and the seller fraudulently or negligently did not disclose the relevant information

(see for example *Dibley v Furter* 1951 (4) SA 73 (C); *Cloete v Smithfield Hotel* 1955 (2) SA 622 (O); *Mayes v Noordhof* 1992 (4) SA 233 (C); M A Millner 'Fraudulent non-disclosure' (1957) 74 SALJ 177). Thus a failure to disclose a concealed graveyard, or the fact that municipality had revoked permission to use adjacent land as a 'septic' tank, or the presence of an informal settlement, have all been held to have an impact on a contract of sale of land. To vitiate a contract, a non-disclosure need not have been fraudulent or negligent, since even an innocent misrepresentation is actionable, but the presence and nature of fault will impact on the relief available (Van der Merwe et al op cit at 115–18).

Nevertheless, the insurance context is different. An insurer typically is not interested in a possible damages claim against the insured; the relief which an insurer seeks is the avoidance of contractual liability to pay out on an insurance claim to the insured. The South African common law used to distinguish between non-disclosure and positive misrepresentation (and to some extent still does), but since the amendment of the Long- and Short-Term Insurance Acts in 2003, the right to avoid an insurance contract for misrepresentation by commission or omission is governed by the same standard of care, namely that of the 'reasonable person'. (See the discussion by Philip Sutherland 'Insurance law' 2003 *Annual Survey of South African Law* 627 at 629–30. This legislative amendment cleared up the confusion created by *Qilingele v South African Mutual Life Assurance Society* 1993 (1) SA 69 (A) as commented on by Schutz JA in *Clifford v Commercial Union Insurance Co of SA Ltd* 1998 (4) SA 150 (SCA) at 155C–159B. See the more recent judgment of Boruchowitz J in *Mahadeo v Dial Direct Insurance Ltd* 2008 (4) SA 80 (W) for confirmation of the effect of this amendment.) The assessment of what the reasonable person would consider material is undertaken by a court, and the opinion of the particular judge(s) substitutes what the insured or insurer might have thought material (*Oudtshoorn Municipality* (supra) at 435F–I). Thus, should an insured fail to disclose a fact in his proposal form (or deliberately submit incorrect information), a court will be called upon to decide, based upon its own judgment, whether or not that representation was sufficiently material to lead to the avoiding of the contract by the insurer. This test is applied to determine materiality in all types of insurance governed by the Long- and Short-Term Insurance Acts.

In addition, it is common drafting practice to insert a 'basis of the contract' clause into proposal forms, by which the proposer is called upon to warrant the accuracy of all representations made by him therein. This type of clause is valid under the South African legislative framework and turns all representations made into affirmative warranties. In the past, such warranties were used to give the insurer a ground for avoiding the insurance policy, regardless of the materiality of the representation. In 1969, this was limited by an amendment of the Insurance Act 27 of 1943 to the effect that such a representation must be material, regardless of whether it had been warranted to be the truth, in order for the insurer to avoid the policy (s 63(3) of the 1943 Insurance Act — see the discussion in *Clifford* (supra) at 156I–157D). This

protection was repeated in the Long- and Short-Term Insurance Acts of 1998 (Reinecke et al op cit para 369) and is further strengthened by the 2003 amendment's 'reasonable person test' for materiality.

Prior to legislative amendment, the issue of the appropriate standard to apply in this context was canvassed at length in *Oudtshoorn Municipality* (supra), with the majority favouring the 'reasonable person test' (at 435F–I) and the minority favouring the 'reasonable insured test' (at 446D–G). As we have argued above, the reasonable person test is more than adequate in the business context, but the same policy arguments do not necessarily hold true in the consumer context. Reinecke & Becker have argued that the test favoured by the minority in *Oudtshoorn Municipality* (supra) would lead to an increase in premiums, which is in not in the interests of the insured (M F B Reinecke & E A Becker 'Die openbaringsplig by versekering: Uberrima fides oorboord' 1985 TSAR 86 at 91). Davis argues against this (Davis op cit at 117n34). These policy arguments pre-date the CPA, however, where the South African legislature has expressed its preference for consumer protection over the interests of business. This is in line with English law, as highlighted in the introduction, and brings relief to consumers who face problems such as inequality of bargaining power and the high cost of litigation.

The CPA expressly excludes insurance from its scope of application. The rationale for this is that the existing Long- and Short-Term Insurance Acts and the Policyholder Protection Rules that are issued from time to time are intended to provide consumer protection in this area. According to Schedule 2 item 10 of the CPA, the exclusion of insurance law from its ambit is subject to the alignment of those laws with the CPA within eighteen months from date of enactment, failing which the CPA will apply to insurance contracts. Eighteen months have passed since the implementation of the CPA, but there are no promulgated amendments as yet. However, there is a Bill tabled before Parliament at present, which aims to bring the Long- and Short-Term Insurance Acts (amongst others) into line with new legislative developments, such as the CPA and the Companies Act 71 of 2008 (the Financial Services Laws General Amendment Bill of 2012). Nevertheless, this Bill does not bring any changes to the law of materiality of misrepresentations in insurance proposal forms. Even so, we will argue below that the trend of consumer protection should now be followed through in the insurance context and that proper consumer protection should be extended to insurance consumers. The UK Consumer Insurance Act will be used as a comparative model to illustrate how this could be done.

## THE UK CONSUMER INSURANCE ACT ON DISCLOSURES AND REPRESENTATIONS

The new UK Consumer Insurance Act (available at <http://www.legislation.gov.uk/ukpga/2012/6/contents/enacted>, accessed on 7 March 2013) brings some clarity to the law concerning applications for consumer insurance,

particularly regarding the completion of insurance proposal forms. As the case law of both the UK and South Africa suggests, this is an area fraught with difficulties, which arise largely from a failure by the insured to make accurate representations. Whether this is due to fraud or negligence — or simply due to a lack of sophisticated knowledge about insurance law on the part of the insured — varies from case to case. Given these difficulties, the task that the UK legislature set itself — to clear up the confusions in the common law and to provide clear guidance on this point — is admirable. The enactment of the UK Consumer Insurance Act in 2012 was the culmination of the research conducted and report produced by the English and Scottish Law Commissions in 2009. (The report of the English and Scottish Law Commissions is available at <http://lawcommission.justice.gov.uk/publications/consumer0-insurance-law-precontract-disclosure-and-misrepresentation.htm>, accessed on 7 March 2013.) The major aims of the UK Consumer Insurance Act are thus to govern the law of disclosure and misrepresentation in the consumer insurance context. This includes the situation where applications for consumer insurance are made through the medium of intermediaries.

The Act is drafted in plain English; hence some of the technical terms familiar to those schooled in the common law are different. This approach seems appropriate for the consumer context as it aids understanding by laypersons, yet does not detract from the meaning of the statute. As we shall see below, it has been crafted with attention to the possible meanings which may be ascribed to plain English words and as such, should stand up to judicial scrutiny. Thus in the definitions section (s 1) we see that the UK Consumer Insurance Act applies to a ‘consumer insurance contract’, which is defined as a contract that is entered into by ‘an individual who enters into the contract wholly or mainly for purposes unrelated to the individual’s trade, business or profession’ and ‘a person who carries on the business of insurance’. In addition, ‘consumer’ is defined as an individual who enters into a ‘consumer insurance contract’, and ‘insurer’ as ‘the other party to a consumer insurance contract’. Thus the Act avoids the legal distinction between natural and juristic persons, preferring the plain English concepts of business versus private insurance. The distinction in the descriptor of an ‘individual’, who may be a ‘consumer’, and a ‘person’, who may be an ‘insurer’, would seem, by implication, to exclude entities such as trusts from the definition of ‘consumer’, whether or not the trust carries on business.

Section 2 of the UK Consumer Insurance Act deals with disclosures and representations made by a consumer to an insurer before entering into or amending a consumer insurance contract. This section imposes a ‘duty of reasonable care’ on the consumer not to make misrepresentations at this stage of contracting (s 2(2)). This duty is said to replace any previous rule of law in this context (ss 2(4) and 2(5)) which effectively does away with the harsher ‘prudent insurer’ test and the difficulties surrounding it.

Importantly, the standard of care required by the Act is that of the ‘reasonable consumer’ (s 3(3)), which sets the bar lower than was previously required under the (English) Marine Insurance Act, 1906 (see above). It is

worth noting at this stage, that the provisions of the UK Consumer Insurance Act are equipped to respond to criticisms of similar provisions in Australian law. The Australian legislature was a forerunner in departing from the harsh rules contained in the (English) Marine Insurance Act of 1906 with its Insurance Contracts Act, 1984 which introduced a 'reasonable person' test as early as 1986 (available at <http://www.comlaw.gov.au/Details/C2013C00077>, accessed on 7 March 2013). However, the provision proved problematic in so far as it contained no guidelines to indicate whether the 'reasonable person' test that it introduced was of an objective or subjective nature. This led to a degree of uncertainty in its implementation, with courts differing on which surrounding factors should be taken into account and which should not (see K Lewins 'Reforming non-Disclosure in insurance law: The Australian experience' 2008 *Journal of Business Law* 158 at 162). The considerations that form part of the definition of the 'reasonable consumer' included in the UK Consumer Insurance Act correspond with those proposed by the Australian Treasury Review (*ibid*) and indicate that English lawmakers favoured an approach focused on extrinsic factors. (The Australian legislature is again considering the duty to disclose and misrepresentations. See the Insurance Contracts Amendment Bill of 2010 available at <http://www.comlaw.gov.au/Details/C2010B00065>, accessed on 7 March 2013.)

The major impact of ss 2 and 3(3) of the UK Consumer Insurance Act together is the lowering of the standard of what constitutes 'reasonable care' on the part of the consumer. Lowry, Rawlings & Merkin note that this new formula does away with the duty of disclosure in this context, since the duty is limited to one not to 'make misrepresentations' (John Lowry, Philip Rawlings & Robert Merkin *Insurance Law — Doctrines & Principles* 3 ed (2011) 144–5).

Section 4 stipulates both the materiality and inducement legs of the test to determine whether a misrepresentation will 'qualify' for redress. Section 5 contains the fault element of the insurance misrepresentation. A 'qualifying misrepresentation' must either be (a) 'deliberate or reckless'; or (b) 'careless'. For a misrepresentation to be deliberate or reckless the consumer must have known it was 'untrue or misleading' or not have cared whether it was such. In addition, the consumer must have known the misrepresentation was relevant to the insurer, or not have cared whether it was relevant to the insurer. Section 5(3) then states that a qualifying misrepresentation would be careless if it was not deliberate or reckless. The onus of showing whether a misrepresentation was deliberate or reckless falls on the insurer (s 5(4)). For the purposes of proving fault in terms of s 5 there is a rebuttable presumption that the consumer had the knowledge of a reasonable consumer and that the consumer knew that 'a matter about which the insurer asked a clear and specific question was relevant to the insurer' (s 5(5)). The concept of an innocent misrepresentation is not included in the section, meaning that the consumer will avoid liability only if a misrepresentation is honest (ie non-fraudulent) and reasonable (see ss 2–5 and the summary included in the



Law Commission Report at para 1.25, available at [http://lawcommission.justice.gov.uk/docs/lc319\\_Consumer\\_Insurance\\_Law\\_Pre-Contract\\_Disclosure\\_and\\_Misrepresentation\\_summary.pdf](http://lawcommission.justice.gov.uk/docs/lc319_Consumer_Insurance_Law_Pre-Contract_Disclosure_and_Misrepresentation_summary.pdf), accessed on 7 March 2013.)

Schedule 1 to the Act deals with the remedies available to insurers for ‘qualifying misrepresentations’. These provisions are detailed, but for present purposes a basic summary will suffice. If the qualifying misrepresentation was ‘deliberate or reckless’, the insurer may avoid the contract and need not return any of the premiums paid, except to the extent that it would be unfair to the consumer to retain the premiums. If the qualifying misrepresentation was careless, the remedy available depends on the likely outcome had the consumer complied with the s 2(2) duty of reasonable care. As a result, if the insurer would not have entered into the contract on any terms, it may avoid the policy and retain the premiums paid. Alternatively, if the insurer would have still entered into the contract, but on different terms, the contract is to be treated as if it had been entered into on those different terms. This may involve a proportionate reduction in the pay-out of an insured’s claim if the insurer would have charged a higher premium without the qualifying misrepresentation.

To sum up, the position on misrepresentation in consumer insurance contracts in terms of the UK Consumer Insurance Act is as follows:

- An insurer will only have a remedy against the consumer if the misrepresentation is found to qualify for redress (s 4).
- A qualifying misrepresentation will exist where a consumer has failed to take reasonable care not to make a misrepresentation and this has induced the insurer to contract with the consumer (s 4(1)(a) and (b)).
- A fraudulent misrepresentation (‘dishonest’) will always indicate a failure to take reasonable care (s 3(4)). A fraudulent misrepresentation may be ‘deliberate’ or ‘reckless’, with the onus of demonstrating fraud being on the insurer (s 5(1), (4) and (5)).
- Alternatively, if the misrepresentation is not fraudulent, but it is demonstrated that the consumer failed to take reasonable care not to make the misrepresentation (the test for ‘reasonable care’ can be found at ss 3(1)–(3)), it will automatically be deemed to be ‘careless’ (negligent) (s 5(3)).
- The consequences for the consumer having made a misrepresentation, which induced the insurer to contract, depend on whether such misrepresentation is found to be deliberate, reckless or careless (Schedule 1 Part 1).

Section 6 deals with attempts by the insurer to convert a representation made in a proposal form into a warranty. According to s 6(2), such a representation is not capable of being converted into a warranty by means of any provision of a consumer insurance contract. Thus the so-called ‘basis of the contract’ clause, which attempts to convert all the pre-contractual representations in the proposal form into terms of the ultimate insurance contract, is not valid. This means that insurers will not be able to avoid the provisions relating to misrepresentations in the UK Consumer Insurance Act by converting the representations into affirmative warranties.



As a further comparison on the topic of non-disclosure/misrepresentation in insurance law, brief mention needs to be made of the position in the Principles of European Insurance Contract Law ('PEICL'). (This body of model law is published in the form of a code with comments and notes. See Jürgen Basedow, John Birds, Malcolm Clarke, Herman Cousy & Helmut Heiss (eds) *Principles of European Insurance Contract Law* (PEICL) (2009).) Here the duty of non-disclosure is stated in art 2:101(1) as follows: 'An applicant shall inform the insurer of circumstances of which he is or ought to be aware, and which are the subject of clear and precise questions put to him by the insurer.' Comment four to this provision notes that there is no distinction drawn between business and consumer applicants, but that courts should nonetheless be aware of differences between applicants. A materiality provision is also included, which relies on the 'reasonable insurer' standard at art 2:103(b). However, as comment three to this provision notes, the duty of disclosure is limited already in art 2:101(1) to providing answers to the insurer's questions.

The PEICL provisions are thus at variance with the South African common law and the UK Consumer Insurance Act. In our opinion, the consumer contexts should be treated differently, particularly in South Africa. Even so, the UK legislature is to be commended for its advancement of the rights of consumers in the field of insurance. Not only has the onerous and insurer-friendly duty of disclosure been cut back, but the standard of care used to determine materiality has been lowered to that of the 'reasonable consumer', whilst the remedies available to insurers have been limited according to the extent to which the misrepresentation induced the contract.

Once again, South Africa lags behind the United Kingdom in the field of consumer protection. Although one could argue that South Africa's 'reasonable person' test is already more consumer friendly than the pre-existing English insurance dispensation, this test represents a one-size-fits-all approach to the determination of materiality which ignores the difficulties faced by inexperienced and unsophisticated subscribers of insurance. Furthermore, market forces should be left to sort out the difficulties (such as the suggested possible increase in premiums) that might result from a shift in the standard of care of consumers. Consumers represent a discernible class of insurance purchasers who deserve different treatment to other purchasers. Such a development would be in line with general trend towards consumer protection and ubuntu in South African contract law. (Apart from the CPA, see *Barkhuizen v Napier* 2007 (5) SA 323 (CC) and *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC).)

The next section considers a possible way in which insurers could still be protected even with the shift in the standard of care, viz the requirement of reasonable knowledge inherent in the reasonable consumer test. This brings the doctrine of constructive knowledge and its concomitant problems squarely into focus.

## THE DOCTRINE OF CONSTRUCTIVE KNOWLEDGE

The end of the twentieth century was marked by what one could call an electronic revolution. The internet, and more recently, the manner in which

modern devices facilitate access to its wealth of resources, has not left the insurance industry unaffected. Many modern insurance companies pride themselves on dealing directly with the insured and 'cutting out the middle-man' to save costs. Insurance contracts are often negotiated and concluded either telephonically or via an insurance company's website (see for example <http://www.outsurance.co.za> or <http://www.dial-direct.co.za>). Another novelty, which can perhaps be termed 'the twenty-first century middle-man', is a service provider that gathers and compares quotes on behalf of the insured and then forwards the latter's details to the desired insurer for further negotiations (see for example <http://www.hippo.co.za>).

Before these developments, insurance was a more tedious and personal affair, where prospective clients were courted and procured by brokers, acting either independently or as agents of insurance companies. The insured, in all likelihood, had far less information at his disposal regarding insurance industry practice and policy. Moreover, the relationship between the insured and the representative of the insurer was often a personal one that resulted inevitably in prospective insurance clients attaching significant value to the representations made — and undertakings given — by such representatives. Complications often arose when the representative of the insurer, unbeknownst to the insured, included incorrect statements in the insurance proposal form or omitted facts material to the risk assumed by the insurer. As we explained above, the consequences of such misrepresentation or non-disclosure were often dire, keeping in mind the insured's duty to disclose and the practice of making the proposal insurance form the basis of the contractual relationship between the insured and the insurer. Importantly, the insurer generally would be able to deny liability unless the knowledge of the agent could be imputed to the insurance company.

This form of imputed knowledge, known as constructive knowledge, is unique to insurance law and is not to be confused with other forms of imputed knowledge (such as the doctrine of constructive notice, which forms part of company law). The doctrine of constructive knowledge in the insurance law context purports to impute to the insurer, the knowledge obtained by its agent from a potential insured (Peter Havenga *The Law of Insurance Intermediaries* (2001) 114–46). In response to application of this doctrine however, one might argue that the agent of the insurer is also given authority to represent the insured by virtue of the insured allowing the agent to fill in a proposal insurance form on his behalf. The question of where the law chooses to place liability for a false representation in such a case thus raises fundamental policy considerations.

In assessing whether the doctrine of constructive knowledge will apply to a given set of facts, the first question is whether the agent had authority (as agent of the insurer) to complete the proposal form. A distinct but related question is whether the knowledge of the agent can then be imputed to the insurer (Havenga *op cit* at 117). These days it is perhaps rare for insurers to appoint agents and authorise them to fill out proposal forms on the insured's behalf. Yet it remains a commercial reality that intermediaries do complete

forms on behalf of prospective clients and that the expectations of these clients is that they can rely on the intermediary to communicate accurately any information conveyed to the insurer (Lowry, Rawlings & Merkin op cit at 64–5; Havenga op cit at 114–46).

Opinions on whether canvassing agents have the requisite authority of the insurer to fill out proposal forms differ, and the South African courts have not yet decided the matter definitively. Havenga describes the argument that the agent has the actual or ostensible authority of the insurer as ‘attractive’ (Havenga op cit at 117). This line of reasoning is also supported by Reinecke et al who argue that the practice of filling in forms on behalf of consumers is so commonplace that authority could be the result of a trade practice in the insurance industry even if it is not expressly granted (Reinecke et al op cit para 499).

On various occasions, both locally and in other common-law jurisdictions, courts have been called on to deal with this conundrum. From a policy standpoint, one of the chief concerns has been the uncertainty that might be introduced if a party to a contract is allowed to show, after the fact, that he was unaware of the contents of a written proposal. As the US Supreme Court said in a seminal case, ‘[c]ontracts could not be made or business fairly conducted, if such a rule should prevail . . .’ (*New York Life Insurance Co v Fletcher* 117 US 519 (1886) at 529). The US Supreme Court held that the mischief in this case (which, in essence, was a fraud committed against both the company and the insured by an agent incorrectly filling in a proposal form) could have been avoided by the insured simply by taking reasonable care and reading the proposal submitted to the insurer. Negligence, in the form of a failure to read the policy, was inexcusable (*New York Life Insurance Co* (supra) at 533).

In contrast, English courts did not consistently turn a blind eye to the plight of an insured who had been misled by an agent of the insurer. In the case of *Bawden v The London, Edinburgh, and Glasgow Assurance Co* [1892] 2 QB 534, the insured was an illiterate individual who had lost an eye in a previous accident. The canvassing agent did not note this partial blindness in the proposal insurance form, which led ultimately to the insurer avoiding Bawden’s claim when he lost the sight in his other eye in an accident. The Court of Appeal concluded that ‘the company are bound by [the agent’s] knowledge, and they are really attempting to throw upon the assured the consequences of [the agent’s] breach of duty to them in not telling them that the assured had only one eye’ (per Lindley LJ at 540).

Subsequent to the decision in *Bawden* (supra), the English courts have been willing to allow the insurer to avoid the contract by distinguishing the relevant case on the basis of its facts (although at times in a rather contrived manner). In *Biggar v Rock Life Assurance Company* [1902] 1 KB 516 at 524 it was concluded that

‘if a person in the position of the claimant chooses to sign without reading it, a proposal form which somebody else filled in, and if he acquiesces in that being

sent in as signed by him without taking the trouble to read it, he must be treated as having adopted it. Business could not be carried on if that were not the law.'

Subsequently, in *Newsholme Bros v Road Transport and General Insurance Co Ltd* [1929] 2 KB 356 at 451, Scrutton LJ made the following comment:

'If the answers are untrue and [the agent] knows it, he is committing a fraud which prevents his knowledge being the knowledge of the insurance company. If the answers are untrue, but he does not know it, I do not understand how he has any knowledge which can be imputed to the insurance company.'

Unlike many of the cases preceding it, the more recent English decision of *Stone v Reliance Mutual Insurance Society Ltd* [1972] 1 Lloyd's LR 469 favoured the approach adopted in *Bawden* (supra). The court (per Lord Denning MR at 475) concluded:

'The untrue answers were written down by their own agent. It was their own agent who made the mistake. It was he who ought to have known better. It was he who put the printed form before the wife for signature. It was he who thereby represented to her that the form was correctly filled in and that she could safely sign it. She signed it trusting to him. This means that she too, was under a mistake, because she thought it was correctly filled in. But it was a mistake induced by the misrepresentation of the agent, and not by any fault of hers. . . [T]heir agent represented that he had filled in the form correctly: and having done so, they cannot rely on the printed clause to say that it was not correctly filled in. So they are liable on the policy.'

The strained attempts by the courts since *Bawden* (supra) to avoid applying that decision, and the uncertainty that eventuated from the resultant conflicting decisions, perhaps point to a lack of clarity on what exactly the doctrine of constructive knowledge demanded. It is also noteworthy that the personal circumstances of the insured seemed to play a key role in convincing the courts of which route to take.

Under South African law, the general requirements for the application of the doctrine of constructive knowledge are twofold. First, any knowledge that stands to be imputed must have been obtained in the course of employment and secondly, the agent must have had a duty to communicate it to the insurer. These requirements were first stated in *Town Council of Barberton v Ocean Accident and Guarantee Corporation Ltd* 1945 TPD 306 at 311, and have since been confirmed and applied in various decisions (see Havenga op cit at 119).

At this stage, it is noteworthy that both the Long- and Short-term Insurance Acts render void any term in an agreement 'the purport of which is that the person who has entered into the . . . policy declares or admits that a person who acted on behalf of the . . . insurer in connection with an offer of that person to do so, or with the negotiations preceding the entering into it, was in fact appointed to act on behalf of the first-mentioned person' (see s 51(b) of the Short-Term Insurance Act and s 56(b) of the Long-Term Insurance Act). Havenga argues that even without the prohibition of 'transfer of agency' clauses (as above), any attempts to exclude the doctrine of

constructive knowledge contractually would be unlikely to have a significant impact (Havenga op cit at 139).

The South African courts seemed prepared to impute the knowledge of the agent to the insurer in *African Guarantee and Indemnity Co Ltd v Master* (1929) 50 NPd 143. On the other hand, in the earlier case of *London & Scottish Assurance Corporation v Venter* 1923 OPD 209 the court had concluded that the insurer could indeed escape liability, due to the fact that, amongst other things, the insured had been unable to prove that the agent had sufficiently broad powers of representation and the fact that the insured had warranted the truth of the proposal form and had signed it.

In *National Employers Mutual General Insurance Association v Gany* 1931 AD 187, the Appellate Division (as it then was) was of the opinion that the 'heavy onus' resting on the plaintiff had not been discharged and that he had not successfully proved that he (the insured) did in fact provide the insurance representative with the correct information. Stratford JA confirmed the fact that knowledge will only ever be imputed to the insurer in cases where it can be shown that the true facts had been disclosed to the agent (at 202–4).

Following *Gany* (supra), the Eastern Districts Local Division established that no knowledge acquired by an agent could be imputed to the insurer in cases where the insured gave permission for the agent to fill out the proposal form on his behalf. This was due to the fact that the agent became an amanuensis of the insured in these cases (*Brolis v London Assurance Co* 1931 EDL 186).

In a later decision by the Eastern Districts Local Division (*Ying & another v South British Insurance Co Ltd* 1957 (2) SA 194 (E) at 198), the court seemed to take an approach that was more lenient towards the insured when it concluded:

'[I]t seems to be . . . that to require that the agent who obtained the knowledge must in every case be an agent authorised to conclude the contract, is to place the requirement too high. Whilst the knowledge of an agent with authority to conclude would ordinarily be imputed to the company, there may be cases where an agent is specially employed to receive or ascertain information on behalf of the company, yet his authority falls short of actually concluding the contract. In such a case I think that the knowledge of the agent would be regarded as the knowledge of the company. I venture to suggest, therefore, that in a case like the present, where there is no allegation of actual knowledge on the part of the defendant, that a plaintiff must at least prove, and therefore allege, that the agent who received the information was an agent authorised by the defendant to receive information on its behalf.'

On the facts, however, the court was not prepared to accept that the plaintiff had alleged and proved facts to support even this narrower test and as a result, did not grant the relief sought.

In spite of the fact that there have been some outcomes favourable to the insured party, a review of the relevant case law tells a cautionary tale. The agent generally is not seen as having authority to gather information on behalf of the insured. What is more, the insured must take responsibility for

any document that he signs, including any misstatements that it may contain. This state of affairs is not immune to criticism (Havenga *op cit* at 135); not least because it does not reflect the expectations of insured parties when dealing with intermediaries.

## AGENCY AND THE UK CONSUMER INSURANCE ACT

Insurers today have access to detailed statistical data and highly sophisticated mechanisms to determine and assess risk. Documents are kept electronically, which means that information previously obtained is easily accessible and modern communication devices have all but eradicated any challenges posed by distance. The duty to disclose 'reflects, first, the potentially mortal impact inadequate information poses to the insurance industry's vitality, and second, the practical reality that certain critical information may be peculiarly within the insured's knowledge and difficult to elicit' (J Tarr & A Tarr 'The insured's non-disclosure in the formation of insurance contracts: A comparative perspective' (2001) 50 *International & Comparative Law Quarterly* 577 at 578). For years, this so-called asymmetry of information was the main reason why the onus to comply with an open-ended duty to disclose remained almost entirely on the insured. Technology has done much to rectify this asymmetry and the law must remain in step with practice (*ibid*).

The introduction of the UK Consumer Insurance Act is especially commendable in light of the above. Schedule 2 to the Act attempts to provide some clarity regarding the vexing question of agency and the implications of constructive knowledge. According to para 2(a) of the schedule, an agent is to be taken as the insurer's agent if he does something in the capacity of an agent, as the appointed representative of the insurer for purposes of s 39 of the Financial Services and Markets Act, 2000 ('FSMA'). In brief, this section determines that an agent must be party to a contract with his principal in terms of which the principal has accepted in writing that the agent is permitted to carry on business of a prescribed description and the agent in fact complies with these prescriptions (FSMA, s 39(1)). Secondly an individual is an agent for collecting information or entering into contracts respectively, only if he had been given express authority by the insurer to do so (UK Consumer Insurance Act, Schedule 2, para 2(b) and (c)).

In all other cases, the agent is assumed to be acting on behalf of the consumer, unless 'it appears, in light of all the relevant circumstances that the agent is acting as the insurer's agent' (Schedule 2, para 3(1)). Schedule 2, paras 3(3) and 4 set out factors which may be relevant in making such a determination. On the one hand, factors listed as tending to confirm that the agent is acting for the consumer are that the agent undertakes to give impartial advice to the consumer, the agent undertakes to conduct a fair analysis of the market and the consumer pays the agent a fee (Schedule 2, para 3(3)(a)–(c)). On the other hand, examples of factors which may tend to show that the agent is acting for the insurer include instances where the agent places insurance of the type in question with only one of the insurers who provide insurance of

that type; the agent is under a contractual obligation which has the effect of restricting the number of insurers with whom the agent places insurance of the type in question; the insurer provides insurance of the type in question through only a small proportion of the agents who deal in that type of insurance; the insurer permits the agent to use the insurer's name in providing the agent's services; the insurance in question is marketed under the name of the agent; or where the insurer asks the agent to solicit the consumer's custom (Schedule 2, para 4(a)–(f)).

The provisions of the UK Consumer Insurance Act acknowledge that each case will have to be decided on the basis of its specific facts. The 'reasonable consumer' presumption in s 5(5) addresses the lack of certainty that has plagued the doctrine of constructive knowledge by stipulating clearly the necessary standard of care that a consumer should assume when filling out a proposal form with the aid of an intermediary. At its core, the presumption in s 5(5) does not focus on whether the company knew a particular fact, or whether knowledge can be imputed. Rather, it focuses on whether the insured complied with his duty not to make a misrepresentation. In our opinion, the basing of the test on the behaviour of the insured will lead to more equitable outcomes. The provisions are also drafted in such a manner that they can apply equally, regardless of whether the insurance contract is concluded directly (eg online or telephonically) or via an intermediary. This is because the test remains focused on the conduct of the insured as objectively measured in each case.

Furthermore, the fact that the onus to prove fault is on the insurer (s 5(4)) addresses difficulties often faced by an insured party who has to prove that the correct information was conveyed to the agent. This is to be welcomed and at first glance echoes the sentiments expressed by the South African court in *Ying v South British Insurance Co Ltd* (supra).

It is also interesting to note that, unlike its Australian counterpart, the UK Consumer Insurance Act does not contain a provision mandating the insurer to inform the insured of the importance of providing accurate answers, the consequences of not complying with the duty to disclose or an explanation of its relationship with the agent. In our opinion, such a requirement to notify the insured would go a long way in ensuring a consumer friendly insurance industry and would be in line with the spirit of compatible provisions contained in the CPA (see s 49 of the CPA, which requires notice to be given to the consumer if certain terms are included in an agreement, and ss 22–28 which deal generally with the right to disclosure and information). Such a duty also corresponds with art 3:101 of the PEICL, which deals with the powers of insurance agents. In terms of art 3:101 of the PEICL, an agent is authorised to perform all acts on behalf of the insurer that, according to current insurance industry practice, are within the scope of his employment. In this context, authority at least covers the actual scope of employment and includes the power to inform and advise the policy holder and to receive notices from the policy holder. Finally, art 3:101(3) of the PEICL determines that relevant knowledge, which the insurance agent has or ought to have in



the course of his employment, shall be the knowledge of the insurer. Importantly, the policyholder must be notified of restrictions clearly and in a separate document.

Although the UK Consumer Insurance Act does much to eradicate the harsh application of insurance law principles against the insured, it still assumes, at least to some extent, that the insured is aware of the implications of both his answers in the proposal insurance form as well as the relationship between the agent and the insurance company. A requirement that the insurer provide a clear statement informing the insured of the exact scope of the agent's authority and the implications thereof, would not place an unreasonable burden on the insurer and might ensure that fewer consumers find themselves without cover due to misrepresentations made by themselves or canvassing agents.

A final improvement to adapt the UK Consumer Insurance Act to the South African context might be a more nuanced definition of the term 'consumer'. This is especially appropriate in the South African context where there is a great need to ensure that small enterprises gain access to insurance. A small, one-person business, whether operated as a sole proprietorship, a close corporation or a private company, does not imply by any means that the such business proprietor is a more prudent consumer than the individual taking out insurance in a private capacity. In fact, the consequences of an insurance policy being avoided by an insurer could be even more disastrous for these proprietors, who often operate in the informal sector and rarely enjoy the protection of legal personality against claims of creditors should the small business fail. Perhaps, a more appropriate definition for the South African context would be one that does not distinguish between business insurance and personal insurance but rather, one that defines the term 'consumer' in a manner that includes small businesses, either by means of a turnover threshold or some other appropriate mechanism. This would be in line with the concept of 'consumer' applicable under the CPA.

## CONCLUSION

The fact that South Africa is slowly but surely embracing a more consumer friendly regime is evidenced by recent statutory developments, such as the CPA, the National Credit Act 34 of 2005 and the Companies Act 71 of 2008. These statutes have made great strides toward ensuring that the relevant contracts are concluded fairly in an environment where consumers can expect greater transparency and equity in their dealings with service providers.

The fact that the South African legislature favours a consumer-oriented change in the insurance industry is evidenced by the provisions of the CPA which call for development in this area (see Schedule 2, Item 10 to the CPA). The UK Consumer Insurance Act is a good example of the certainty that legislative intervention can bring to what has been a troubled and often consumer unfriendly area of English law. The focus of the UK Act on

misrepresentation and non-disclosure by the insured consumer, including in the agency context, finally settles the debates discussed above in favour of the consumer. Although, the South African standard of the 'reasonable person' in this context is already more consumer friendly than the traditional English-law position, perhaps the shift toward greater consumer protection in other areas of South African contract law should also be reflected by reducing our standard of care in such cases to a 'reasonable consumer' standard.

In similar vein, the prohibition on transfer of agency clauses in the South African Long- and Short-Term Insurance Acts may not be going far enough in protecting the insured from the negligence of insurance intermediaries. In addition, our legislature should also clarify the law surrounding questions of exactly when errors in a proposal form can be attributed to the intermediary rather than the insured, particularly if that insured is a consumer. In other words, the exact scope of application of the doctrine of constructive knowledge should be clarified by the legislature in the new insurance legislation (as contemplated by the CPA), with greater protection for unsophisticated insured parties.

In sum, the purpose of this note was to draw attention to the latest English statutory development in the context of consumer insurance law. We hope that the points we have highlighted here will be taken account of when our own consumer insurance legislation is developed.